APPENDIX

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 74-1698

UNITED STATES OF AMERICA,

Plaintiff,

v.

AMERICAN TELEPHONE AND TELEGRAPH COMPANY;
WESTERN ELECTRIC COMPANY, INC.; AND
BELL TELEPHONE LABORATORIES, INC.,

Defendants.

Civil Action No. 82-0192

UNITED STATES OF AMERICA,

Plaintiff,

v.

WESTERN ELECTRIC COMPANY, INC., AND
AMERICAN TELEPHONE AND TELEGRAPH COMPANY,

Defendants.

MEMORANDUM OF THE UNITED STATES IN RESPONSE TO THE COURT'S OPINION OF AUGUST 11, 1982

The United States submits this Memorandum in response to the Court's Opinion of August 11, 1982 ("Opinion") in which the Court indicated that it would approve the agreement reached between the United States and AT&T in the above referenced actions on the condition that the parties agree to several modifications. The Opinion requires the parties, within fifteen days, to submit to the Court a proposed decree incorporating the Court's proposed modifications, or a statement that they are not prepared to incorporate such modifications. Because

the alternatives available would pose unacceptable costs to the public interest, including delay in the reorganization process, the United States is prepared to agree to the Court's revisions, and will transmit that assent to the Court on or before the date set in the Court's order. The United States respectfully urges the Court, however, to consider modifying one of its proposed revisions.

In brief, the United States proposes that, to the extent the BOCs are permitted to market customer premises equipment, the type of such equipment be limited, at least for the present, to residential or single-line business customer premises equipment. For the reasons set forth below, the United States continues to believe that there is a very substantial competitive danger in allowing BOCs to provide, without limitation, more complex customer premises equipment. The United States therefore suggests that a post-divestiture proceeding consistent with the standards and procedures proposed at pages 116-117, 176 [J.A. 113-114, 170] of the Opinion would provide an appropriate occasion to consider removal of the restrictions with respect to such complex equipment.

Deferral of this decision would permit the Court to consider the difficult question of BOC entry into these particular competitive markets on the basis of a record focused on the particular facts and circumstances relevant to the competitive costs and benefits of BOC participation. This procedure would not entail the risks to the public interest that we believe would flow from BOC provision of complex customer premises equipment. At the same time, if on hearing the evidence and argument presented, the Court determines that the particular plans for marketing complex CPE that the BOCs propose do not present substantial competitive danger, the procedure would delay BOC entry little, if at all, beyond the time it could occur under the Court's August 11 proposals. In summary we ask the Court to consider whether the decree would meet the public interest standard if it allowed immediate BOC entry into marketing relatively simple CPE, but postponed a decision as to marketing complex CPE until the development of a record

addressed to the distinct problems such marketing presents, under the general standard the Court has established and in light of the particular plans the BOCs may propose.

The rationale for the Court's proposed modification allowing the BOCs to market, but not manufacture, customer premises equipment is that marketing, in contrast to manufacturing, presents "little potential for anticompetitive behavior" because the incentives of the BOCs and "their practical ability" to engage in such behavior "would be minimal." Opinion at 110. [J.A. 107.] The Court found that the possibility of discrimination would be remote because "it would be difficult for an Operating Company to conspire successfully with a manufacturer to provide advance information about revised network standards or to impose interconnection restrictions which favored that manufacturer's products and no one else's."[1] *Id.*

In its Response to Comments, at page 68, the United States agreed that BOC provision of certain types of customer premises equipment, such as residential and single-line business customer premises equipment might well entail little competitive risk.[2] On the other hand, the Department stated that provision by the BOCs of more complex customer premises

---

[1] In contrast, the Court found that if the BOCs were permitted to manufacture customer premises equipment they would have "the ability to discriminate against equipment manufactured by others with respect to types of interconnections, testing, maintenance and similar matters." Opinion at 109. [J.A. 106.] As set forth below, if the BOCs were permitted to market, but not manufacture complex customer premises equipment, they might well have the very same ability to discriminate against the offerings of firms other than firms with which the BOCs have distribution arrangements.

[2] Residential and single-line business customer premises equipment includes equipment like telephone handsets, answering and recording devices, and data modems that can be purchased essentially "off the shelf" and installed by the customer with little or no necessary coordination with the local telephone company.

equipment, which necessarily involves a high degree of coordination between the equipment provider or customer and the local exchange carrier with respect to such matters as installation, maintenance, testing, and restoration, would pose substantial competitive dangers. In a different context, the FCC recognized significant distinctions between the installation and maintenance of residential and business customer premises equipment. In its opinion on further reconsideration of its *Second Computer Inquiry* decision the FCC stated: "We do not dispute AT&T's contentions that the installation and maintenance of business systems, such as PBX and key telephone systems, involve a degree of complexity that does not exist for single party residential service. In fact, based on how business is now actually conducted in the marketplace, there is little similarity between the installation and maintenance problems associated with residential and business equipment. . . . Our registration program also established common interfaces for various business systems. Yet the operational problems here are different from those in the residential arena. Business systems such as PBX and key telephone systems require more complex installation and maintenance." *Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), Memorandum Opinion and Order on Further Reconsideration*, at 19-20, §§ 53, 57 (Released October 30, 1981). None of the pleadings filed by interested persons appears to contest this distinction nor the ability of the BOCs to disadvantage competitors in the provision of sophisticated customer premises equipment.[3]

---

[3] The Brief of the Federal Communications Commission on Question No. 2 did not dispute the potential for anticompetitive conduct with respect to sophisticated customer premises equipment, but asserted that there is no evidence that such conduct has in fact occurred since the recent implementation of the CPE registration program. Brief at 9. The FCC suggested that "[a]t the very least, the prohibition should be revised to permit BOCs to provide CPE when Justice does not view the provision of CPE as a potential source of a

The Court appears to rest its conclusion that BOC provision of CPE would be procompetitive in large part upon the assumption that, shorn of ownership of a CPE manufacturer, a BOC would have no incentive to discriminate against the products of particular CPE providers. The validity of this assumption is, however, undercut to the extent that the BOCs distribute the products of only a limited number of manufacturers. While the BOCs will not have an incentive to choose their source of supply in a discriminatory manner, the decree might be interpreted to permit, and the impracticability of training installation and maintenance forces to install and service multiple suppliers' equipment may dictate, the choice of only one supplier, or a limited number of suppliers, for a particular type of equipment. As the North American Telephone Association (NATA) put it in its Reply Brief at 12, "[n]o distribution business can willy-nilly buy everybody's products. Each piece of equipment imposes new and different sales, installation and maintenance requirements; and each of these functions for each new product creates new and different training requirements. Hence, standardization on products becomes a practical business necessity if cost efficiencies and productivity are to be achieved." See also Stipulation Package 57C, Stipulation 71. For similar reasons, manufacturers of complex CPE may prefer that their products be marketed, installed, and maintained by personnel owing primary allegiance to their products, and thus avoid the use of multiproduct vendors.

A BOC selling the products of only a limited number of manufacturers would have a strong incentive to use its local

---

discrimination problem." *Id.* The Brief of the Public Service Commission of the District of Columbia on Topic Number 2 stated at page 5, "[t]he potential for such discrimination, if it exists at all, will exist only with respect to sophisticated expensive equipment, such as PBXs." The Brief of the Kansas Commission did not dispute the possibility of anticompetitive conduct, but stated that "[t]he manner in which equipment is interconnected would seem to be only secondary considerations" and that in any event regulatory authorities could easily detect such conduct. Kansas Commission Brief at 5.

exchange activities to achieve supracompetitive profits in the provision of nonregulated CPE, or even if CPE remained regulated, to expand the ratebase. The BOCs would thus have an incentive to disadvantage rival CPE providers. Moreover, the BOCs would have available several means of discriminating against their competitors in the provision of complex CPE in ways that could seriously undermine their ability to compete with BOC provided products on an equal basis.[4] Installation of new large customer premises switching systems may, for example, involve re-wiring entire buildings, re-engineering cable under the streets, and adjustments in local area network planning to accommodate the new installation. Installation of CPE used in the provision of innovative information services, such as centralized voice storage, may require even more complex interaction with the BOCs to implement particularized information access arrangements. The ability to guarantee these activities on schedule, with a smooth cutover to the new system, likely will often be critical to the customer's purchase decision. Permitting the BOCs to engage in the provision of such equipment and systems would give them the incentive and the ability to prefer their own products in these important activities. Likewise, the maintenance and testing of sophisticated equipment and systems offer similar opportunities for such behavior.[5] See NATA Brief at 7, note 2; Opinion at 109,

---

[4] It should be noted that it would not require a conspiracy between the BOC and the manufacturer to engage in such conduct successfully since it would be in the BOC's independent interest to do so and require little or no cooperation from the manufacturer.

[5] The consent decree, as written, only prohibits discrimination by the BOCs between AT&T and other enterprises. It thus does not address in injunctive terms the discrimination between other manufacturers and suppliers that could occur if the BOCs were permitted to offer complex customer premises equipment. As the Court has explained in other contexts, injunctive provisions are unlikely to foreclose this kind of discrimination effectively in any event. Even if injunctions were an appropriate remedy here, however, the United States believes that it would be necessary to carefully tailor the injunctive provisions to deal specifically with the problems that are likely to arise.

[J.A. 106] note 244. In sum, the United States continues to believe that BOC provision of customer premises equipment other than residential or single-line business customer premises equipment would present a substantial threat to the public interest and that there is no evidence or argument to the contrary now before the Court.[6]

The Court need not now reach a conclusion on this issue, however, to protect the public interest fully. Under the third modification proposed by the Court, the restrictions on the BOCs may be removed upon a showing by a BOC that "there is no substantial possibility that it could use its monopoly power to impede competition in the market it seeks to enter." Opinion at 176. [J.A. 170.] This, the United States believes, is an entirely appropriate standard for removal of the restrictions. The United States believes, however, that with respect to customer premises equipment more complex than residential or single-line business equipment, this standard could best be applied in a separate proceeding pursuant to the procedures

---

[6] The Court's Opinion notes that permitting BOC provision of customer premises equipment would avoid "unnecessary intrusion into matters of direct interest to the states and state regulators. . . ." Opinion at 112, [J.A. 109] note 250. The United States believes that to the extent that there is a state interest in the provision of business customer premises equipment by the BOCs, it is overridden, just as any state interest in BOC provision of interexchange services is overridden, by the federal interest in assuring competitive telecommunications markets. Moreover, the United States is unaware that any state has expressed a distinct interest in having the BOCs provide complex business equipment. Indeed, to the extent that states have expressed specific concerns about customer premises equipment, the concerns appear to center on the provision of more basic types of residential equipment to rural customers or the less affluent. Of course, if customer premises equipment is dergulated pursuant to the FCC's *Second Computer Inquiry* decision, there will be no legitimate state interest in the provision of such equipment. If customer premises equipment remains regulated, on the other hand, the BOCs' incentive and ability to disadvantage competitors through cross-subsidization will only be increased.

developed by the Court for removal of other BOC line of business restrictions. The United States believes that this approach would provide an appropriate and effective mechanism for examining the likely competitive costs and benefits of BOC marketing, not only of such complex equipment as PBXs, but other less complex equipment that might, like residential and single-line business equipment, present relatively insubstantial competitive dangers. This procedure would provide the Court the opportunity to examine the question of BOC entry on a complete and focused record devoted exclusively to that question.[7] The BOCs would have every incentive to provide the Court the best evidence and argument at their disposal in support of lifting the restriction. If, indeed, BOC provision of complex customer premises equipment presents no substantial danger to competition the BOCs should be able to carry their burden. If not, of course, the restriction should be retained.

In addition, this procedure would pose no threat to the public interest in the interim between the entry of the consent decree and post-divesture proceedings in the event that the Court then finds that the restriction should be removed. First, the restriction, if retained, would not take effect until divestiture so that the BOCs could continue to offer customer premises equipment until that date to the extent permitted by regulatory authorities. Second, because embedded customer premises equipment will be transferred to AT&T, the BOCs could not, in any event, begin to offer such equipment immediately after divestiture. This procedure would thus provide the most complete possible protection of the public interest. It would permit

---

[7] As the United States explained in its Response to Comments, it is difficult to draw a viable distinction between products that present substantial competitive dangers and those that do not. Deferral of the decision on BOC entry would permit the Court to draw this distinction for particular kinds of equipment with respect to which the BOCs are able to show little likelihood of discriminatory conduct, based on a BOC's actual business plans.

full consideration of all relevant evidence and argument and would do so without impairing the public interest in vigorously competitive customer premises equipment markets at the earliest possible date.

Accordingly, the United States respectfully requests that the Court defer its consideration of BOC entry into the provision of complex customer premises equipment and amend its first proposed modification in the following manner:

VIII

A. Notwithstanding the provisions of section II(D)(2), the separated BOCs shall be permitted to provide, but not manufacture, residential and single-line business customer premises equipment.

Respectfully submitted,

/s/ _____

JAMES P. DENVIR
Attorney
Antitrust Division
United States Department of Justice
Washington, D.C. 20530
(202) 724-5778

WILLIAM F. BAXTER
Assistant Attorney General
Antitrust Division

RONALD G. CARR
Deputy Assistant Attorney General
Antitrust Division

RICHARD O. LEVINE
Director
Office of Policy Planning
Antitrust Division

Dated: August 19, 1982.

CERTIFICATE OF SERVICE

I, James P. Denvir, one of the attorneys for the United States, hereby certify that I have on this day served the *Memorandum of the United States In Response To The Court's Opinion Of August 11, 1982* on defendants by delivering a copy thereof to:

GEORGE L. SAUNDERS, JR., ESQ.
SIDLEY & AUSTIN
c/o AT&T
499 South Capitol Street
8th Floor
Washington, D.C. 20003

/s/ _____
JAMES P. DENVIR

Dated: August 19, 1982

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 74-1698

UNITED STATES OF AMERICA,

Plaintiff,

v.

AMERICAN TELEPHONE AND TELEGRAPH COMPANY;
WESTERN ELECTRIC COMPANY, INC.; AND
BELL TELEPHONE LABORATORIES, INC.,

Defendants.

Civil Action No. 82-0192

UNITED STATES OF AMERICA,

Plaintiff,

v.

WESTERN ELECTRIC COMPANY, INC., AND
AMERICAN TELEPHONE AND TELEGRAPH COMPANY,

Defendants.

MEMORANDUM OF THE UNITED STATES

Many of the changes that the Court prescribed in its August 11 opinion before it will approve the proposed consent decree reflect and make explicit matters that, in the view of the United States, were implicit in the decree as submitted by the parties. To these changes, which place the decree's obligations in more concrete form, the United States readily agrees. As the papers it previously has filed in this matter indicate, however, the United States has substantial doubts that certain other changes are properly within the scope of the Court's authority under the public interest standard, or are supported by the antitrust theory and the record in these cases. The United States believes, in particular, that the revision allowing the BOCs to market customer premises equipment presents a significant risk of anticompetitive conduct, relating primarily to the marketing of complex business equipment,

although the extent of the risk depends on how the revision is interpreted. Despite its reservations on these points, the United States believes that the public interest can be served only if the reorganization of AT&T, which lies at the center of the proposed decree and which the Court unequivocally has approved, is undertaken as soon as possible. The alternatives to accepting the Court's revisions would delay the reorganization indefinitely, with great costs to the industry and ultimately the public. Accordingly, the United States has decided to accept the Court's revisions and submits herewith, for entry by the Court, a revised decree, stipulated to by AT&T and by the United States, that incorporates the changes the Court required in its August 11 opinion.*

Respectfully submitted,

/s/ Ronald G. Carr

RONALD G. CARR
Deputy Assistant Attorney General
Antitrust Division
United States Department of Justice
Washington, D.C. 20530
(202) 633-2411

Dated: August 24, 1982

---

*In the process of incorporating the Court's modifications, the parties discovered a number of minor typographical errors in the decree as originally submitted. These errors, with one exception, have been corrected in the revised decree and are reflected in the errata sheet appended to this Memorandum. In Section IV of the decree as originally submitted, the paragraph designation "M" was inadvertantly omitted, so that paragraph "N" follows paragraph "L." This omission was simply an error in alphabetizing and does not reflect a substantive omission. Because these and subsequent paragraphs have been referred to in various pleadings filed with the Court, correction of this error in the revised decree might cause confusion in the future. The parties, therefore, have not changed Section IV to correct this typographical error.